WHY WALL STREET'S SMARTEST SHARKS ARE BUYING UP JUNK BONDS

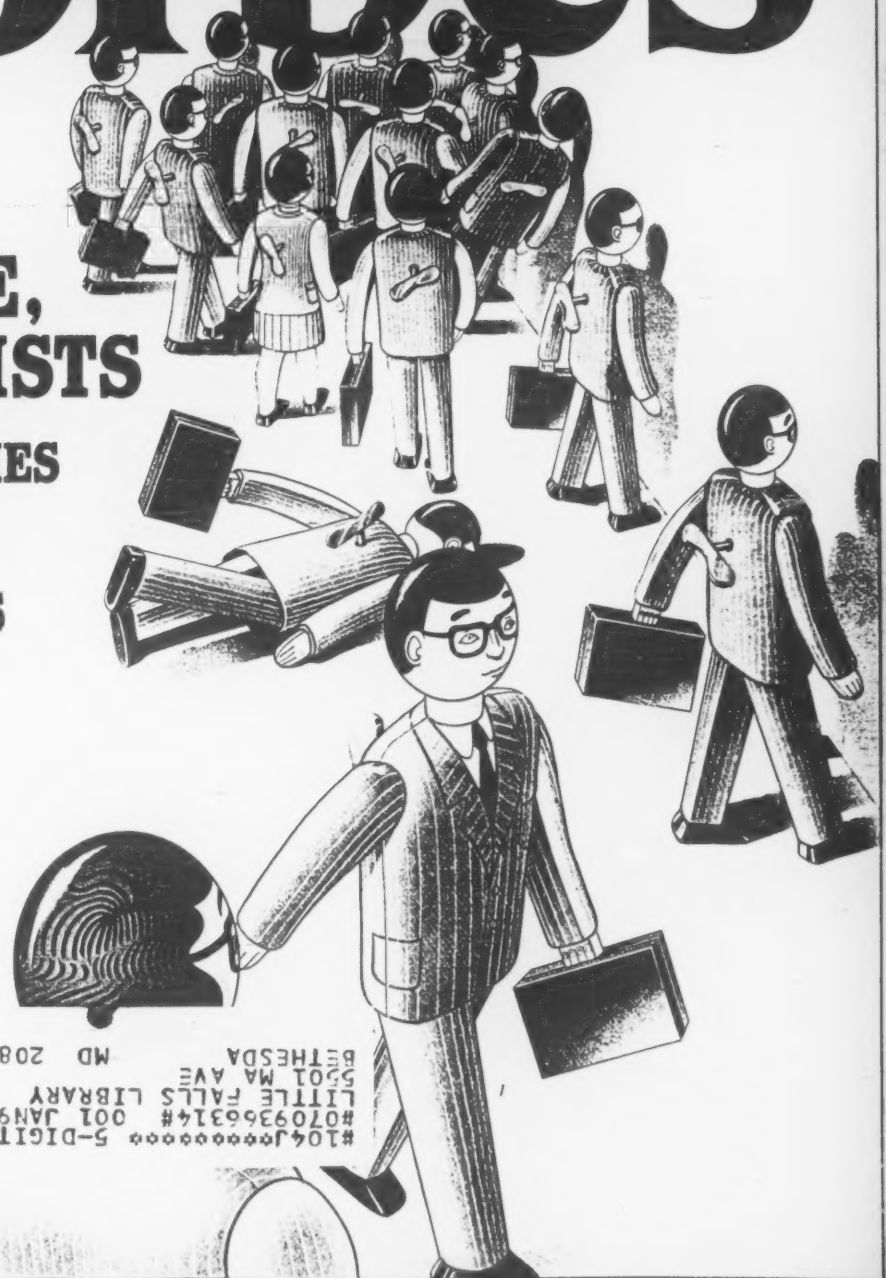
CUBA: AFTER CASTRO, A DELUGE?

THE SOVIET UNION: FOOD FOR PEACE? OR CIVIL WAR?

JANUARY 21, 1991

FOUR DOLLARS

Forbes



GOODBYE, ECONOMISTS

WHY COMPANIES ARE SACKING THEIR SOOTHSAYERS

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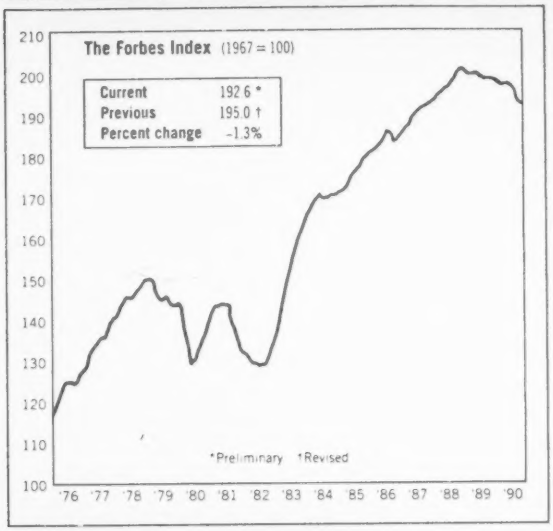
The Forbes Index



The preliminary Forbes Index figure for November shows a 1.3% decline from October. If this holds, it will put the Index at its lowest point since February 1988. Contributing factors: Manufacturers' new orders fell 10%, new housing starts 14%. But the Consumer Price Index rose only 0.2%. The summer's spike in oil prices has, so far, had only a minimal impact on the cost of other goods and services, and commodity prices in general are weak *(see p. 112)*. The Federal Reserve recently acted to drive interest rates lower in hope of stimulating the economy.

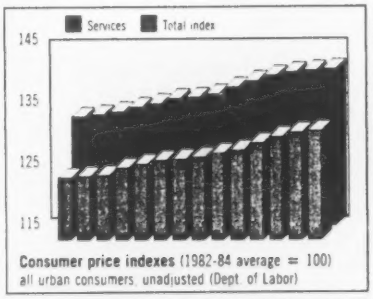
Other key rates	Source	Status
Prime rate	Chase Manhattan Bank	10.0%
Auto sales year to date vs. 1989[1]	Ward's Automotive	-2.6%
Index of leading indicators November vs. October	Dept. of Commerce	-1.2%
Trade balance 12 months ended October 1990	Dept. of Commerce	-$103 bil
Producer price index November vs. 1989[2]	Dept. of Labor	7.0%
GNP 3rd quarter vs. 2nd—annualized growth	Dept. of Commerce	1.4%†
NBER Experimental Recession Probability Index[3]	Natl. Bureau of Economic Research	14.0%

[1]U.S.-based manufacturers, excludes imports, as of 12/10/90. [2]Finished goods. [3]November 1990. † Revised.

Index Components

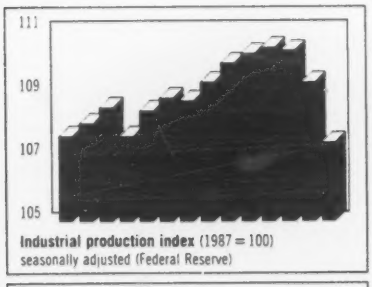
The Forbes Index is a measure of U.S. economic activity composed of 8 equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, new housing starts, total retail sales, the level of new orders for durable goods compared with manufacturers' inventories, personal income, total consumer installment credit.

To measure these 8 elements, FORBES monitors 10 series of U.S. government data. The last 14 months' data for each series are presented below.



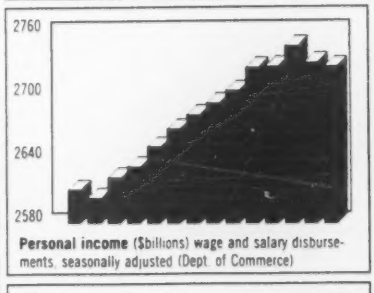
Consumer price indexes (1982-84 average = 100) all urban consumers, unadjusted (Dept. of Labor)

Manufacturers' new orders and inventories ($billions) seasonally adjusted (Dept. of Commerce)

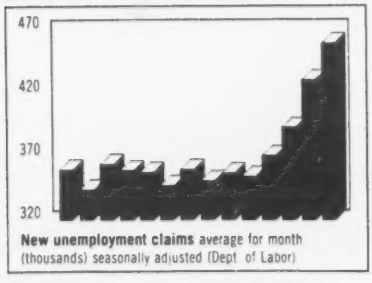


Industrial production index (1987 = 100) seasonally adjusted (Federal Reserve)

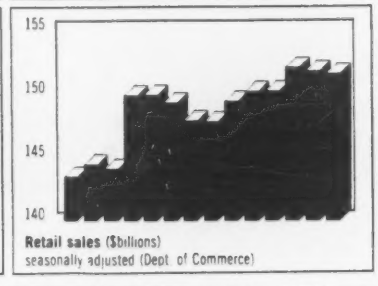
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)



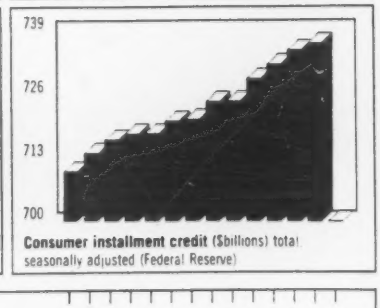
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)



New unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)



Retail sales ($billions) seasonally adjusted (Dept. of Commerce)



Consumer installment credit ($billions) total seasonally adjusted (Federal Reserve)

The Forbes Wall Street Review

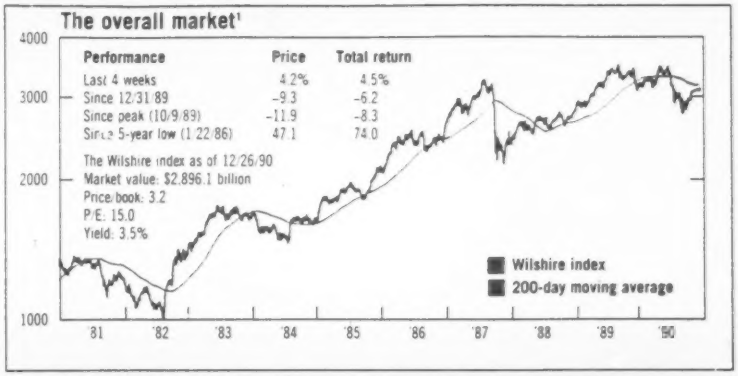
By Eric S. Hardy

"I see the current stock market weakness as a sharp interruption caused by the Persian Gulf crisis," observes Stephen Leeb, editor of *Personal Finance*. "What we had is essentially a tax hike caused by higher oil prices. I don't think the economy is nearly as weak as people say."

Leeb believes that the Dow industrials will climb above the 3000 mark, possibly as high as 3250, in 1991. Then the market will turn strongly bearish and fall to the 2500-to-2600 range. Why the sharp decline? "The Fed will probably overdo it and let loose too much credit and then have to clamp down when inflation starts," Leeb replies.

Leeb is attracted to "vultures," or companies that can take advantage of weak competitors. Although he doesn't particularly like the banking or the airline industries, he sees opportunities because so many weak competitors are there. "The strong get stronger in bad economic times—whether it is J.P. Morgan or Delta Airlines," he notes. Leeb also recommends BankAmerica, Sterling Bancorp, AMR and UAL.

As 1990 drew to a close, the Wilshire index of 6,000 stocks was showing a loss of 9% for the year, although during the last two weeks it managed to eke out a 0.2% gain. The Dow Jones industrial average was off 4.8% for the year and up 0.6% for the same two-week period.



The Best Performing Stocks

Company	Price	2-week change	P/E	Avg vol (thou)[2]	Rel vol[3]
Lafarge	13¼	20%	11	245	0.9
Flightsafety International	47	16	22	586	0.7
JWP	15¾	16	11	3,037	1.5
Amax Gold	14⅛	15	41	109	0.8
Seagate Technology	11⅞	14	7	9,589	1.5

The Worst Performing Stocks

Company	Price	2-week change	P/E	Avg vol (thou)[2]	Rel vol[3]
National Health Labs	11¼	-27%	14	7,441	4.4
Marriott	11⅛	-19	11	2,435	0.5
USF&G	7½	-17	5	8,988	1.8
Genentech	23	-16	NM	2,344	1.3
Castle & Cooke	29	-15	14	3,424	2.2

Closeup on the Market

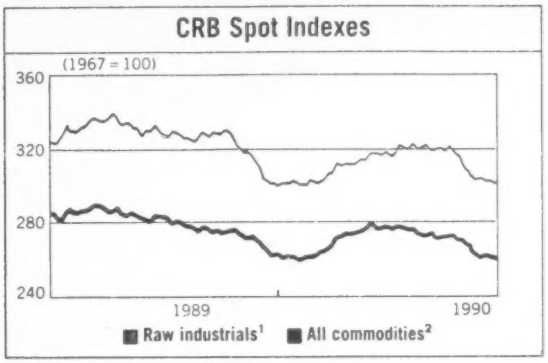
Index or investment	Price	2-week change
Wilshire index 6,000 stocks, capitalization weighted	3,102.4	0.2%
Wilshire index 6,000 stocks, equal weighted	16.8	-0.5
Dow Jones industrials 30 stocks, divisor-adjusted price average	2,637.1	0.6
S&P 500 Capitalization weighted cross section, major stocks	330.9	0.2
NYSE Capitalization weighted, all listed common stocks	180.6	0.2
Amex Capitalization weighted total return: stocks, warrants	305.0	-0.9
Nasdaq Capitalization weighted, all issues except warrants	372.5	0.6
Amex international market index Capitalization weighted, 50 largest ADRs	289.2	-4.1

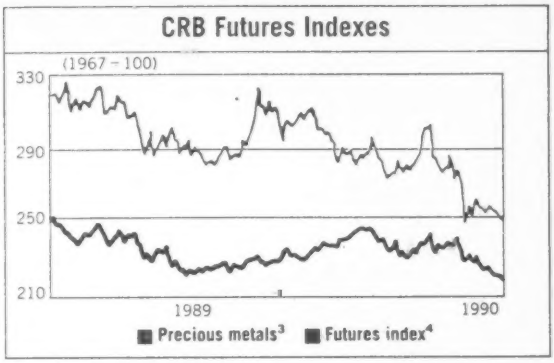
Index or investment	Price or rate	2-week change
Europe, Australia, New Zealand and Far East[4] (EAFE) a dollar denominated capitalization weighted index	781.20	-5.3%
Institutional[5] Approximately 200 stocks with high institutional ownership	97.32	1.8
Individual[5] Approximately 200 stocks with low institutional ownership	81.20	-3.2
Russell 2000 index 2000 stocks with small market values, capitalization weighted	130.83	0.2
Gold[6] (composite quote of 5 major dealers)	$384.90	3.3
Yen[6] (per $U.S.)	136.30	3.8
Commodity index[6] (CRB futures index, 1967 = 100)	220.73	-0.1
Oil[6] (W Texas Intermediate)	$27.20	7.3
T bills[6] (90 days)	6.45%	-33 basis points[7]
Broker loan rate[6]	9.25%	unchanged

Note: All data for periods ending 12/26/90. Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. Stocks listed above have market capitalizations of $500 million or more. [1]Capitalization weighted, prepared by Wilshire Associates, Santa Monica, Calif. [2]Average daily volume over a 2-week period. [3]Average daily volume over the last 2 weeks, divided by the average daily volume over the preceding 3 months. [4]Morgan Stanley Capital International Perspective. [5]For period ending 12/26/90. A. Arbel, Cornell University, using Ford Database from Ford Investor Services. [6]Knight-Ridder Financial Information. [7]A basis point is equal to one-hundredth of a percentage point. NM: Not meaningful.

Commodities Review

By Eric S. Hardy





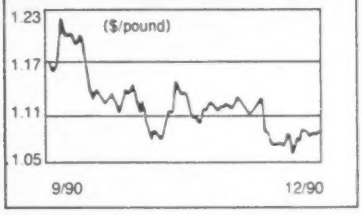
The Commodity Research Bureau Futures Index dropped 7% over the last three months while the two energy-related components of this index (crude oil and heating oil) show an average change of –11%. Of the 21 components in this equally weighted index, 3 are precious metals—gold, platinum and silver. The CRB index on these metals fell 10% since mid-September. Silver futures traded below $4 an ounce for the first time since February of 1976. Defying the expectations of goldbugs, precious metals turned out to be a terrible inflation hedge and poor protection against geopolitical uncertainty in the 1980s.

The overall Consumer Price Index was up 6% through November 1990, but the futures market is signaling that prices of commodities are headed lower. Downward pressure on commodity prices helps keep inflation in check, but not as much as it did, say, in the 1930s.

"The correlation [of commodity prices] with the CPI isn't what it used to be," argues James Nevler, an analyst for Knight-Ridder's Commodity Research Bureau. "The engineering component of cost, rather than the raw materials cost, is what counts." Think of it this way: If you are buying a personal computer, the cost of the plastic and metal is not important. The designer's salary is.

For the year, the raw industrial commodities tracked by the Commodity Research Bureau were up about 0.6%, while the all-commodities index (which includes 10 foodstuffs in addition to the 13 industrial components) was off fractionally.

Commodity Spotlight



Deflationary forces: Copper is piling up in warehouses. Chile recently opened the world's third-largest copper mine, to supply 418,000 tons a year of copper concentrate to the Japanese. And the housing market, which accounts for 42% of the copper used in the U.S., is in a prolonged slump. All this explains why, over the last three months, the March copper contract dropped 8%, to $1.10.

Cash and Futures Prices

Spot Indexes			Futures Indexes		
Index[6]	Value	3-mo change	Index[6]	Value	3-mo change
All commodities	258.83	–5%	CRB index	220.68	–7%
Raw industrials	301.11	–6	Precious metals	250.84	–10
Metals	282.81	–14	Industrials	237.36	–12
Textiles	257.73	–2	Grains	172.03	–2
Foodstuffs	207.86	–3	Livestock & meat	228.21	3

Spot Commodity Prices			Futures Prices		
Commodity	Price	3-mo change	Commodity	Price	3-mo change
Steel scrap (short ton)	104.00	–8%	Jan platinum (troy oz)	407.20	–13%
Copper scrap (pound)	0.90	–13	Feb crude oil (barrel)	25.92	–12
Print cloth (sq yard)	0.82	4	March copper (pound)	1.10	–8
Corn (bushel)	2.26	4	March cotton (pound)	0.76	5
Soybean oil (pound)	0.21	–13	March Chi wheat (bushel)	2.62	–10

Notes: All prices as of 12/21/90. [1]Composed of 13 commodities. [2]Composed of the 13 raw industrial commodities plus 10 foodstuffs. [3]Gold, platinum and silver. [4]Composed of 21 commodities. [5]Prices from 9/3/90 through 12/12/90. [6]Base for spot and futures indexes (1967 = 100). Source: Knight-Ridder Commodity Research Bureau.

Statistical Spotlight

Research and development is a form of capital expenditure, an investment in tomorrow's business. Which companies are making the biggest R&D investments?

Plowing it back

By Robert Balancia

MERCK & Co., which has wowed Wall Street with its scientific prowess, spent $4.5 billion on research and development from 1980 through 1989. As impressive as this figure is, Merck is not an industry leader in R&D spending—not in percentages. Over the past five years the company has made R&D outlays averaging 11.5% of sales, while Syntex is at 16.6% and Marion Merrell Dow at 14.3%.

Which companies are the biggest investors in research? We searched the Media General database in Lotus One Source for manufacturers with at least $100 million in sales whose ratios of R&D-to-sales are considerably higher than the norms for their industries. Other things being equal, a company that puts a lot of money into research should command a higher price/earnings multiple. That's because R&D outlays, deducted immediately from earnings, are a form of investment in future earnings.

There is, of course, a different sort of risk in scientific research than in tangible capital investments, like warehouses and steel mills. Says Jami Rubin, a drug industry analyst at Bear, Stearns: "Only 1 in 5,000 ideas for drugs makes it to market, and only 1 in 5 compounds that make it from the labs into clinical testing ever reaches consumers." Merck's research has paid off with such blockbusters as Mevacor, the anticholesterol drug, and Vasotec, the heart drug. Other researchers haven't been as lucky.

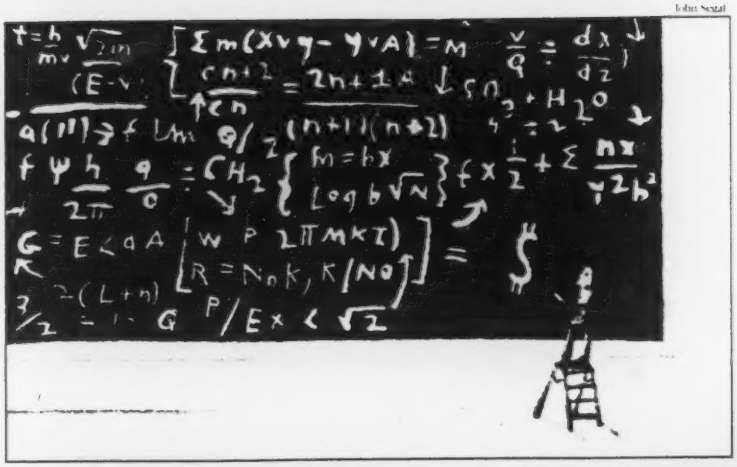
Heavy R&D spending is also essential to survival in the aerospace industry. Over the last five years Boeing

Big spenders

These firms have been spending more out of each sales dollar on research and development than their industry-group peers. (The score in the far right column is scaled so that 100 means tying the industry in the ratio of R&D to sales.) Many of these companies, not surprisingly, trade at high multiples of their earnings.

Company/industry	Recent price	P/E	Debt/ equity	Earnings per share current	Earnings per share 1991 estimated	Earnings per share estimated 5-year growth	5-year average R&D/ sales	R&D versus industry
Boeing/aerospace & defense	46¼	13.9	4%	$3.32	$5.04	17%	4.2%	113
Dow Chemical/chemicals	45¾	8.1	48	5.68	4.23	9	5.0	141
EI du Pont de Nemours/chemicals	36⅝	10.7	27	3.42	3.57	9	4.1	115
General Signal/precision instruments	38	27.0	65	1.41	4.01	9	6.1	115
Ingersoll-Rand/heavy machinery	37	9.5	20	3.89	3.62	10	3.7	121
KLA Instruments/precision instruments	9⅛	22.8	0	0.40	0.40	15	10.6	200
Eli Lilly/drugs	74½	19.9	7	3.74	4.71	18	12.7	119
Lockheed/aerospace & defense	32⅞	16.6	89	1.98	5.07	6	4.9	131
Marion Merrell Dow/drugs	35½	13.7	7	2.60	1.98	13	14.3	134
McDonnell Douglas/aerospace & defense	40⅞	11.9	93	3.43	5.27	7	4.1	110
Merck/drugs	88⅜	20.3	3	4.35	5.34	18	11.5	107
Millipore/precision instruments	36	18.5	26	1.95	2.29	14	7.5	141
Northrop/aerospace & defense	19¼	6.7	67	2.86	2.95	8	4.4	118
Procter & Gamble/personal care prods	86⅝	19.4	55	4.47	5.84	12	3.1	168
Rohm & Haas/chemicals	35¾	12.5	27	2.87	2.87	10	6.3	177
Sundstrand/aerospace & defense	28¾	9.6	41	2.99	3.05	11	5.9	158
Syntex/drugs	58⅛	17.9	37	3.24	3.61	15	16.6	155
Trinova/heavy machinery	18¾	9.6	31	1.92	1.92	10	3.8	124
United Technologies/aerospace & defense	46⅝	17.9	41	6.02	6.03	9	5.3	142
Upjohn/drugs	38¾	9.6	15	1.18	2.65	13	13.9	130

Sources: Media General; Institutional Brokers Estimate System (a service of Lynch, Jones & Ryan), via Lotus One Source.



John Sextal

spent 4% of its sales on designing new aircraft and equipment. The aerospace giant now has a backlog of $86 billion and has 34 firm orders for the new 777 airliner it just launched.

In many industries there appears to be a positive relationship between the amount spent on R&D and Wall Street's expectations of future growth. Investors seem willing to pay a premium for earnings backed by heavy R&D over earnings backed by merely routine R&D. In addition to a 1991 earnings estimate, our table shows a five-year earnings growth rate as projected by the Institutional Brokers Estimate System. Note that where analysts see high R&D they frequently project higher growth than for companies with less R&D. ■

The Funds

Money manager Michael Price is having trouble following a tough act—his own. Is this just a temporary lapse, or has he lost it?

Bear market blues

By Richard Phalon

WIZARDRY in bear markets has traditionally been a very strong suit at Michael Price's Mutual Series family of funds (Mutual Shares, Qualified and Beacon). When much of the competition got creamed between mid-1983 and mid-1984, Price and his mentor, Max Heine, produced double-digit gains. In the crash year of 1987 Price pulled yet another impressive plus out of his sleeve.

On form, then, in a market slide shaping up as the worst in 15 years, Price should be knocking them dead. But he is not even keeping up. Price's two biggest funds—the $2.6 billion Mutual Shares and the similarly managed $1 billion Mutual Qualified—were off 10% in 1990 (through Dec. 26). That compares with a 5% decline for the S&P 500 average. (Both numbers include reinvested dividends.) "I'm giving myself a C on performance," says Price, "maybe a C–, because we work harder." It's a comedown for Price, whose funds rated an A+ in downmarket performance over the long pull in the FORBES fund survey *(Sept. 3, 1990)*. Beacon rates a B, but that grade reflects, in part, several years of mediocre performance before Heine and Price took over the fund.

Price, long the legendary Max Heine's right-hand man, bought Mutual's management company

The good old days

Mutual Shares, the flagship fund of Michael Price's Mutual Series family, turned in its best results when it was much smaller than it is now.